FILE COPY

Nos. 226 and 227

In the Supreme Court of the United States

OCTOBER TERM, 1935

MANHATTAN GENERAL EQUIPMENT COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

IN PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and regulations involved	2
Statement	2
Argument	4
Conclusion	9
Appendix	10

CITATIONS

Cases:	
Arizona Grocery v. *Atchison Ry.*, 284 U. S. 370	8
Bamberger v. *Commissioner*, 27 B. T. A. 785; 67 F. (2d) 983	7
Brushaber v. *Union Pacific Railroad Co.*, 240 U. S. 1	8
Burnet v. *S. & L. Bldg. Corp.*, 288 U. S. 406	7
Champ Spring Co. v. *United States*, 47 F. (2d) 1, certiorari denied, 283 U. S. 852	7
Cooper v. *United States*, 280 U. S. 409	8
Gt. Northern Ry. v. *Sunburst Co.*, 287 U. S. 358	8
Hecht v. *Malley*, 265 U. S. 144	8
Lynch v. *Hornby*, 247 U. S. 339	8
Murphy Oil Co. v. *Burnet*, 287 U. S. 299	7
Phipps v. *Bowers*, 49 F. (2d) 966	8
Titsworth v. *Commissioner*, 73 F. (2d) 385	7
Updike v. *United States*, 8 F. (2d) 913	8
Statutes:	
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 203 (U. S. C. App., Title 26, Sec. 934)	10
Sec. 204 (U. S. C. App., Title 26, Sec. 935)	10
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 605 (U. S. C. Supp. VII, Title 26, Sec. 1691)	11
Miscellaneous:	
Treasury Regulations 69, Art. 1599	11
T. D. 4144, VII–1 Cumulative Bulletin 55	12
T. D. 4274, VIII–2 Cumulative Bulletin 240	12

8079—35

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 226

MANHATTAN GENERAL EQUIPMENT COMPANY, petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 227

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC., petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 42–52)[1] is reported in 29 B. T. A. 395. The opinion

[1] The records have been separately printed. However, the cases were consolidated before the Board of Tax Appeals (see Record in Manhattan General Equipment Company case, p. 1), and disposed of in a single opinion both in the Board of Tax Appeals and in the Circuit Court of Appeals. Unless otherwise indicated, references to the record are to the record in the Manhattan General Equipment Company case, No. 226.

of the Circuit Court of Appeals (R. 69–77) is reported in 76 F. (2d) 892.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered April 22, 1935 (R. 84). A petition for rehearing was denied May 22, 1935 (R. 88). The petition for writs of certiorari was filed July 8, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where, pursuant to a reorganization, a stockholder in 1925 receives stock in another corporation without surrender of his original shares and in 1926 sells the old shares, should the basis for measuring the gain or loss on sale be determined by apportioning the cost of the old shares between the old and the new under the method provided by Article 1599 (2) of Regulations 69 as amended subsequently to 1926, or under the method provided by that regulation as originally promulgated in 1926?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved appear in the Appendix, *infra,* pp. 10–13.

STATEMENT

During the year 1926 the petitioners were affiliated with United Brokerage Company and a num-

ber of other corporations. They filed consolidated returns, and the Commissioner determined the proportion of the tax which should be assessed against each of them (R. 29–33).

The total capital stock (4,964 shares of common) of one of the affiliates, Artemas Ward, Inc., a New York corporation, had been acquired by United Brokerage Company at a cost of $3,414,345.63 (R. 36). On December 31, 1925, the total net assets of Artemas Ward, Inc., had a fair value of $1,246,920.07 (R. 37). On that date Artemas Ward, Inc., transferred all its assets, with the exception of cash and accounts receivable aggregating $284,967.21, to another corporation of the same name organized under the laws of Delaware. In exchange the Delaware corporation issued all its capital stock (100 shares) to the New York corporation (R. 37).

Immediately thereafter, on the same day, the New York corporation distributed to its sole stockholder, United Brokerage Company, the 100 shares of stock of the Delaware corporation, together with accounts receivable aggregating $234,967.21, thus leaving the New York corporation with net assets in the amount of $50,000 (R. 37).

In December 1926, United Brokerage Company, in two transactions, sold to an outsider all of its stock in the New York corporation for $49,640 (R. 37–38). The sole question involved in this peti-

tion relates to the method for computing the loss on that sale.[2]

Following Article 1599 (2) of Regulations 69, as amended (see Appendix, *infra*), the Commissioner computed the loss as follows (R. 39–40): He prorated the cost ($3,414,345.63) of Artemas Ward, Inc. (N. Y.) between the New York and Delaware corporations on the basis of their net worth as of the time of reorganization. Thus, the stock of the Delaware corporation was given a base of $2,634,041.66 and the stock of the New York corporation a base of $780,303.97. The base of the stock of the New York corporation was reduced by $234,967.21 (which had been distributed to United Brokerage Company), leaving a net base of $545,336.76. By subtracting the sale price of that stock ($49,640) from the net base, the Commissioner determined a loss of $495,696.76.

The Board of Tax Appeals approved the Commissioner's determination, and its judgment was affirmed by the Circuit Court of Appeals.

ARGUMENT

Article 1599 (2) of Regulations 69, promulgated under Section 203 (c) of the 1926 Act, *infra*, originally provided:

---

[2] Another issue, involving the determination of the proper basis for computing gain or loss on the cancellation of a certain contract, was decided below adversely to the taxpayer. The petition for certiorari, however, states that no review of that question is sought (Pet. 3, note).

> Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. *The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.* (Italics supplied.)

The italicized portion was deleted by T. D. 4274, promulgated November 19, 1929,[3] VIII–2 Cumulative Bulletin 240.

The Commissioner applied the amended regulation, apportioning the $3,414,345.63 basis of the original stock between the old and new shares in proportion to the value of the 4,964 old shares and the 100 new shares at the time of the reorganization (December 31, 1925). The result was a new basis of $780,303.97 for the old stock, which, when diminished by the amount distributed after reorgani-

[3] This change was first made in T. D. 4144, issued on April 3, 1928 (VII–1 Cumulative Bulletin 55), but T. D. 4274 was the final revision.

zation ($234,967.21), left a net basis of $545,336.76. Thus, upon sale of the 4,964 shares for $49,640, the Commissioner allowed a loss of $495,696.76.

The petitioners do not challenge the correctness of the Commissioner's computations under the amended regulation. Nor do they assert that the amended regulation is unreasonable or in conflict with the statute. They contend, however, that the Commisisoner was without authority to apply the amended regulation to a transaction already consummated, and that he should have applied the regulation in its original form, which would have resulted in a $2,167,785.56 loss.[4]

Authority to apply the amended regulation is founded upon Section 1108 (a) of the 1926 Act, as amended by Section 605 of the 1928 Act:

> In case a regulation or Treasury decision relating to the internal revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the ap-

[4] Under the original regulation the basis of the new stock could not exceed its market value at the time of distribution, namely, $961,952.86. Thus, if that amount be deducted from the original basis ($3,414,345.63), the new basis of the old stock would be $2,452,392.77. Accordingly, a loss of $2,167,785.56 would result upon deducting the $234,967.21 accounts receivable subsequently distributed and the amount realized from the sale of the old shares ($49,640).

proval of the Secretary, be applied without retroactive effect.

This section obviously contemplates that amended regulations shall normally be given universal application, both prospective and retrospective, since special permission is required to apply them with exclusively prospective effect. Amended regulations under the income tax laws have been repeatedly applied to govern transactions fully consummated before. *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 303–304; *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 410; *Titsworth* v. *Commissioner*, 73 F. (2d) 385 (C. C. A. 3d); *Champ Spring Co.* v. *United States*, 47 F. (2d) 1, 2 (C. C. A. 8th), certiorari denied, 283 U. S. 852. See also *Bamberger* v. *Commissioner*, 27 B. T. A. 785, disposed of by stipulation, 67 F. (2d) 983 (C. C. A. 10th).

Neither the statute nor the decisions distinguish in this respect between what the petitioners term "interpretive" and "legislative" regulations. The cases cited above negative any such distinction. Thus, in the *Murphy Oil Co.* case the regulation prescribed the method of allocating depletion to bonus and royalties; in the *S. & L. Building Corporation* case, the method of allocating profits upon the installment sale of mortgaged property; and in the *Titsworth* case, as in the case at bar, the method of apportioning the cost basis of stock retained after reorganization. In each instance the statute

left to the Commissioner the determination of the formula, and the formula applied was promulgated after the transactions in question were completed. We submit, therefore, that the amended regulation rather than the original regulation was properly applicable to the transactions herein.

Arizona Grocery Co. v. *Atchison Ry.*, 284 U. S. 370, is not authority to the contrary. In that case the Interstate Commerce Commission was denied the power retroactively to change a maximum reasonable rate previously fixed. But there no statutory provision comparable to Section 1108 (a) existed acknowledging the power to make such amendments. Cf. *Great Northern Ry.* v. *Sunburst Co.*, 287 U. S. 358.

Nor is the retroactive operation of the amended regulation unconstitutional. Retroactive income tax laws have received continued judicial sanction. *Brushaber* v. *Union Pacific Railroad Co.*, 240 U. S. 1, 20; *Lynch* v. *Hornby*, 247 U. S. 339, 343; *Hecht* v. *Malley*, 265 U. S. 144, 164; *Updike* v. *United States*, 8 F. (2d) 913 (C. C. A. 8th); *Phipps* v. *Bowers*, 49 F. (2d) 996 (C. C. A. 2d). The retroactivity is even less questionable where the new provision does not impose a new tax but merely changes the basis for computing gain or loss. *Cooper* v. *United States*, 280 U. S. 409.

CONCLUSION

The decision below is correct. There are no conflicting decisions. The petition should be denied.

Respectfully submitted.

STANLEY REED,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
ARNOLD RAUM,
Special Assistants to the Attorney General.

AUGUST 1935.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 203. * * *

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized. * * * (U. S. C. App., Title 26, Sec. 934.)

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; * * *.

(U. S. C. App., Title 26, Sec. 935.)

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

(U. S. C. Supp. VII, Title 26, Sec. 1691.)

Treasury Regulations 69, promulgated August 28, 1926:

ART. 1599. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 203 (c) and article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

* * * * *

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are

distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.

This Article was amended by T. D. 4144, VII–1, Cumulative Bulletin 55, promulgated April 3, 1928, by striking out the last sentence of Paragraph (2) thereof. It was further amended by T. D. 4274, VIII–2, Cumulative Bulletin 240, 241–242, promulgated November 13, 1929, in which Paragraph (2) was made to read as follows:

> Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security with which such share or unit belongs, divided by the number of shares or units in the class.

Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

U. S. GOVERNMENT PRINTING OFFICE: 1935